Nos. 20799, 20800, 20801

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MIRRO-DYNAMICS CORPORATION,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal from the Judgment of the United States District Court for the Southern District of California.

BRIEF FOR APPELLANT.

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Opinion Below.

The Decision of the District Court is reported at 247 F. Supp. 214. The findings of fact and conclusions of law [R. 277-284] are not officially reported.

Jurisdiction.

This appeal involves an alleged overpayment of federal income taxes for the fiscal years ended Oct. 31, 1958, 1959 and 1960.

No. 20799

For the 1959 fiscal year the taxpayer paid income taxes of $249,863.38 plus interest of $3,274.27 in installments between Jan. 15, 1960 and Nov. 15, 1960. On May 10, 1963, additional income taxes of $4,426.93

plus interest of $131.05 were paid. [R. 68-69.] On Sept. 6, 1963 a timely claim for refund for $200,695.42 was filed with the District Director of Internal Revenue at Los Angeles. [R. 4 *et seq.*] The complaint herein was filed May 22, 1964 pursuant to 28 U.S.C. §§ 1340, 1346(a)(1). [R. 2.] Summary Judgment was entered Nov. 23, 1965. [R. 286.] Within 60 days and on Jan. 19, 1966 plaintiff filed a notice of appeal. [R. 289.] Jurisdiction is conferred on this Court by 28 U.S.C. §1291.

No. 20800

For the 1958 fiscal year the taxpayer paid income taxes of $134,447.23 plus interest of $759.01 in installments between Jan. 14, 1959 and Nov. 23, 1959. On Aug. 19, 1959, additional income taxes of $7,043.18 plus interest of $121.85 were paid. [R. 66-67.] On Nov. 8, 1963 a timely claim for refund of $37,491.95 was filed with the District Director of Internal Revenue at Los Angeles. [R. 305 *et seq.*] The complaint herein was filed May 22, 1964 pursuant to 28 U.S.C. §§ 1340, 1346(a)(1). [R. 303.] Summary judgment was entered Nov. 23, 1965. [R. 286.] Within 60 days and on Jan. 19, 1966 plaintiff filed a notice of appeal. [R. 289.] Jurisdiction is conferred on this Court by 28 U.S.C. §1291.

No. 20801

For the 1960 fiscal year the taxpayer paid income taxes of $278,027.71 plus interest of $10,944.11 in installments between May 3, 1961 and Oct. 31, 1961. [R. 70.] On Sept. 6, 1963 a timely claim for refund of $279,721.96 was filed with the District Director of Internal Revenue at Los Angeles. [R. 336.] The complaint herein was filed May 22, 1964 pursuant to 28 U.S.C. §§ 1340, 1346(a)(1). [R. 334.] Summary judg-

ment was entered Nov. 23, 1965. [R. 286.] Within 60 days and on Jan. 19, 1966 plaintiff filed a notice of appeal. [R. 289.] Jurisdiction is conferred on this Court by 28 U.S.C. §1291.

Each of the aforementioned claims for refund was based on a net operating loss deduction generated by net operating losses sustained in the 1961 and 1962 fiscal years, which plaintiff seeks to carry back to the years here sued upon.

Questions Involved.

1. Whether ordinary, rather than capital, losses resulted from the everyday operation of plaintiff's business of buying and selling securities.
2. Whether the determination as to whether plaintiff's sales of securities were made in the everyday operation of its business created triable issues of material fact requiring denial of the Government's motion for summary judgment.

Statute Involved.

Internal Revenue Code of 1954, §1221(1), 26 U.S.C. §1221(1):

§1221. Capital Asset Defined.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

> (1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

Statement.

In light of the fact that

(1) judgment was entered in these actions pursuant to the Government's motion for summary judgment,

(2) there were no agreed facts contained either in a stipulation or pre-trial conference order,

(3) the only affidavit in support of the motion for summary judgment, by the Assistant United States Attorney defending the case, was insufficient under Fed. R. Civ. P. 56(e), and

(4) the trial court's decision [R. 235] was in large part premised on facts not contained in pleadings, answers to requests for admissions and interrogatories, or depositions,

it is more than somewhat difficult to present intelligently the operative facts which are in the record.

The taxpayer-Appellant is a California corporation organized in 1947 under the name Pacific Bolt Corporation. [R. 65.] In 1959 the corporate name was changed to Fullview Corp. [R. 65.] Prior to April, 1961 taxpayer was in the business of manufacturing and selling sliding glass doors. [R. 258.] Inventories thereof were maintained by the taxpayer and were priced at cost or market, whichever is lower. [R. 65.] In the spring of 1961 the taxpayer sold substantially all of its assets which related to its former business of manufacturing sliding glass doors, for a cash consideration approximating one million dollars, discontinued the sliding door business, its then only business, changed its name to Mirro-Dynamics Corporation, and moved its offices

to 961 N. La Cienega Blvd., Los Angeles, Calif. [R. 258.]

Pursuant to resolution of the board of directors, taxpayer opened accounts with brokers, in order to go into the business of buying and selling stocks and other securities. At the same time taxpayer maintained an office at H. Hentz & Co., in Beverly Hills, a New York Stock exchange member firm. [R. 258.] The taxpayer's two principal officers devoted their entire time daily from 7 a.m. to the corporation's business of buying and selling securities, which was its only business. At various times the taxpayer made attempts to acquire large blocks of stock with a view to effecting public distribution thereof and with a view to maintaining a market therein. [R. 258.]

During its fiscal year ended Oct. 31, 1961 the taxpayer purchased a total of $3,023,313.91 worth of securities which were sold for $3,039,658.41 in hundreds of different transactions. [R. 7 *et seq.*] During its fiscal year ended Oct. 31, 1962 the taxpayer purchased and sold in the course of its business thousands of shares of stock in several hundred different transactions. Inventories were maintained of all of such securities. During that year the taxpayer sold securities with a cost of $4,944,582.49 for $4,038,721.02. [R. 175 *et seq.*; 258.]

During 1961-1962 taxpayer was actively, directly, and continuously engaged in the business of buying and selling securities, for cash and on margin, dealing in puts and calls, and selling short. [R. 258.] Not all of taxpayer's transactions were effected through brokers. At no time did taxpayer purchase or sell any securities with an investment motive. At various times taxpayer's

officers dealt directly with principals. The taxpayer had no other business activities after April, 1961. [R. 259.]

The claims for refund filed for 1959 and 1960 are primarily premised on net operating loss carrybacks of the $905,861.47 loss generated in the 1962 year in the securities' business and a deduction for federal transfer taxes of $1,592.60. Other deductions claimed are not here in issue as they were conceded by the defendant, and gave rise to the affirmative judgments in the plaintiff's favor for the 1958 and 1959 years. [R. 286-287.]

During an audit by the Internal Revenue Service of plaintiff's affairs, plaintiff was advised that since the inventories of sliding doors had been priced at cost or market, whichever is lower, it was an improper change of inventory pricing to price inventories of securities at cost. [R. 259.] In order to reflect the pricing of its closing inventory of securities at cost or market, whichever is lower, the operating loss for the 1961 year was increased, thereby generating an additional net operating loss deduction for 1958. [R. 305 *et seq.*]

Without any finding of fact as to what plaintiff's business was during 1961-1962, other than the subsidiary finding that plaintiff purchased and sold securities solely for its own account [R. 282, Par. 14], the trial court granted the Government's motion for summary judgment on the basis that all of plaintiff's securities were not inventory and were capital assets [R. 283], resulting in a capital loss of $905,861.47 which cannot be carried back.

For the 1958 year, plaintiff had judgment for $4,312.08 based on a conceded dividends received deduc-

tion for 1961 in the sum of $8,292.46. [R. 286, 281.] For the 1959 year, plaintiff had judgment for $7,518.07 based on conceded dividends received and state transfer tax deductions in the total sum of $14,461.83. [R. 287, 281.] For the 1960 year, plaintiff took nothing. [R. 287.]

Specification of Errors.

1. The District Court erred in granting defendant's motion for summary judgment.

2. The District Court erred in failing to find and conclude that there were genuine issues of material fact to be tried.

3. The District Court erred in failing to make a finding or conclusion as to whether there were or were not any genuine issues of material fact to be tried.

4. The District Court erred in considering the Affidavit of Arthur M. Greenwald in determining the motion for summary judgment.

5. The District Court erred in considering anything but the pleadings in making its findings of fact.

6. The District Court erred in concluding that the securities bought and sold were capital assets.

7. The District Court erred in concluding that the loss from its securities' business in the sum of $905,-861.47 was a capital loss.

8. The District Court erred in failing to find that plaintiff did inventory its securities.

9. The District Court erred in not rendering judgment as prayed for in the amended complaints.

10. The District Court erred in concluding that the scope of plaintiff's business was not a question of fact.

Summary of Argument.

In 1962 the plaintiff corporation's everyday operation of its business consisted of buying and selling securities. If the losses which plaintiff incurred in this everyday operation are characterized as ordinary losses, they may be carried back under Internal Revenue Code §172 against the profits which plaintiff made in its everyday operations of prior years. If, however, these losses, which amounted to almost a million dollars, are characterized as capital losses, the whittling away to zero of this fortune, the acquisition of which had only so recently resulted in the taxes which are here sought to be recovered, would by a quirk of language be totally ignored.

As recently as March, 1966, the Supreme Court has enunciated that the purpose of Internal Revenue Code, §1221(1), which excludes from the definition of capital assets "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business", is to differentiate between the "profits and losses arising from the everyday operation of a business" on the one hand and the "realization of appreciation in value accrued over a substantial period of time" on the other. *Malat v. Riddell,* 383 U.S. 569, 572 (1966). The securities involved in the case at bar were each bought and sold by the taxpayer within only a few months, clearly not a "substantial period of time", so that the transactions which were in fact made in the course of the taxpayer's everyday operation, must be classified in the only remaining portion of the Supreme Court's dichotomy, as "profits and losses arising from the everyday operation of a business".

Although the exclusion in §1221(1) provides that the property must be held primarily for sale to customers, the judicial interpretation thereof especially by this Court and that espoused by the Solicitor General before the Supreme Court in *Malat v. Riddell,* 383 U.S. 569 (1966), is that if one is in the business, any sale is to "a customer."

The court below made a conclusion of law that "The plaintiff is not a dealer in securities, *Schafer v. Helvering,* 299 U.S. 171 (1936); Commissioner's Regulations 1.471.5." This conclusion was not based upon any finding of fact. The statement in the court's prior memorandum that "The plaintiff here is not a dealer, for a dealer is one who, as a merchant, buys and sells securities to customers for the profit thereon. *Schafer v. Helvering,* 299 U.S. 171 (1936)" must be disregarded, under the well settled rule that deficiencies in formal findings cannot be filled in by reference to the memorandum decision. In any event, both the *Schafer* case and the regulation cited by the court were concerned with whether the taxpayer would be considered a dealer for the purpose of deciding whether he would be allowed to inventory his securities, turning on whether the taxpayer was a merchant in securities. This Court has held that whether or not one is a dealer for inventory purposes within this definition is not decisive for the purpose of determining whether ordinary income or capital gains are generated by the taxpayer's activities.

§1221, with which we are here concerned, does not define "dealer" and in these actions the tax affect of the taxpayer's pricing of its securities inventory is not materially significant. Whether the taxpayer is a

dealer for inventory purposes is, therefore, immaterial to whether the taxpayer suffered ordinary losses from its business activities. Thus, even if the lower court's conclusion of law that plaintiff was not a dealer for inventory purposes had been based on proper findings and evidence, such a conclusion would be immaterial to the determination of this case.

The lower court's judgment was pursuant to the Government's motion for summary judgment, based only on the pleadings, affidavit of Arthur M. Greenwald, the Assistant United States Attorney handling these actions, and a supporting memorandum. This affidavit was not based on personal knowledge, did not satisfy the conditions of Fed. R. Civ. P. 56(e), and should not have been considered by the court. If this affidavit had been eliminated from the lower court's consideration, then the court would have had before it only the complaints and answers from which to determine whether there were genuine triable issues of material fact. Since a determination of the extent of the taxpayer's activities and its intent and motive in buying and selling securities is essential to such a decision, there is no doubt that there were genuine triable issues of material fact, compelling denial of the motion for summary judgment even if the affidavit had been sufficient. The lower court should have merely determined that there were issues of fact rather than purporting to decide those issues based on the insufficient record before it.

I.

The Affidavit of the Assistant United States Attorney in Support of His Motion for Summary Judgment Was Insufficient Under Fed. R. Civ. P. 56(e) and Should Not Have Been Considered by the Lower Court.

The United States' motion for summary judgment is based on "the pleadings and the affidavit and memorandum in support thereof." [R. 187.] The affidavit referred to is that of Arthur M. Greenwald, the Assistant United States Attorney who represented the government in the lower court in the defense of this case. [R. 188.] The affidavit, which has no exhibits or papers attached [R. 188-191], states, in substance:

Par. 2: Mr. Greenwald is a certified public accountant;

Par. 3: In November 1964, he reviewed certain of the plaintiff's accounting records and papers;

Par. 4: In 1961, plaintiff sold substantially all the assets which related to its former business of manufacturing sliding glass doors and used the cash it received to buy other assets in the form of marketable securities;

Par. 5: Plaintiff maintained a general ledger account in which purchases and sales of securities were summarized;

Par. 6: Plaintiff maintained a liability account reflecting money owed for the purchase of marketable securities;

Par. 7: Mr. Greenwald reviewed plaintiff's income tax returns for the 1961 and 1962 fiscal years. He set forth the total of gains and losses from securities transactions reported therein;

Par. 8: The schedules attached to plaintiff's tax returns are described, but it is not stated whether this description is the conclusion of Mr. Greenwald or someone else or how he came to the conclusion as to the origin of the figures. Was it done by Mr. Greenwald, or is it even ranker hearsay because it was done by someone else?

Par. 9: This states that certain schedules were compared to certain working papers and confirmation slips and account statements. Again, it does not say who made the comparison or who "established" the other allegations of this Paragraph.

Even if the affidavit complied with Fed. R. Civ. P. 56(e), it would not establish sufficient facts to support a summary judgment. The basic issue is as to the taxpayer's intent, which is a factual matter to be tried by the Court, and this affidavit sheds no light on what such intent was.

In any event, the lower court should not have considered this affidavit in ruling on the motion for summary judgment, as it does not comply with Fed. R. Civ. P. 56(e).

Rule 56(e) provides in pertinent part:

"(e) *Form of Affidavits; Further Testimony; Defense Required.* Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith. . . ."

This Court has held that all references to papers which were neither attached to nor served with an affidavit should be disregarded. *State of Washington v. Maricopa County,* 143 F. 2d 871, 872 (9th Cir. 1944). Since Greenwald's affidavit refers to numerous papers and documents which the lower court did not have before it, the affidavit was insufficient and should not have been considered in determining the motion for summary judgment.

In addition, the Assistant United States Attorney defending the action could have no personal knowledge of the operative facts. His affidavit lays no foundation for his competency and his testimony would not be admissible at the trial. *Hoston v. J. R. Watkins Co.,* 300 F. 2d 869, 870 (9th Cir. 1962); *Paramount Pest Control Service v. U.S.*, 304 F. 2d 115, 116 (9th Cir. 1962); *Durovic v. Palmer*, 342 F. 2d 634, 637 (7th Cir. 1965); *Fowler v. So. Bell Tel. Co.,* 343 F. 2d 150, 154 (5th Cir. 1965); *Willetts v. General Telephone Directory Co.,* 38 F.R.D. 406, 409 (S.D. N.Y. 1965); *Young v. Atlantic Mut. Ins. Co.,* 38 F.R.D. 416, 418 (E.D. Pa. 1965). Rule 56(e) is quite explicit in requiring affidavits to be made on "personal knowledge" and has resulted in rejection of an affidavit of an assistant U.S. attorney based "upon knowledge and information gained from examination of the files of the Internal Revenue Service." *Wellhouse v. Tomlinson,* 197 F. Supp. 739, fn. 2 (S.D. Fla. 1961).

Greenwald's incompetency to testify as a witness is further demonstrated by the fact that it would be clearly improper and unethical for defense counsel to take the witness stand and attempt to testify as to his opinions and hearsay conclusions, based on his own investigation.

Indubitably, it is undesirable to permit counsel for one of the litigants to attempt to inject his interpretation of the facts where he has no personal knowledge thereof.

In view of the fact that Greenwald is incompetent to testify as a witness and has no personal knowledge of the facts and the fact that the affidavit is deficient under Rule 56(e) in that no copies of the papers referred to were supplied, the lower court should not have considered his affidavit.

Without this affidavit, the motion for summary judgment is premised only on "the pleadings ~~and the affidavit,~~ and memorandum in support thereof." [R. 187.] It must, therefore, be considered a motion for judgment on the pleadings. *Mercantile Nat. Bank v. Franklin Life Ins. Co.,* 248 F. 2d 57, 59 (5th Cir. 1957).

A motion for judgment on the pleadings "must be denied 'unless it appears to a certainty' that plaintiffs are 'entitled to no relief under any state of facts which could be proved in support of the claim'." *Brown v. Bullock,* 194 F. Supp. 207, 247 (S.D. N.Y. 1961), *aff'd* 294 F. 2d 415 (2nd Cir. 1961). Such a criterion is not appreciably different from that used in determining a motion to dismiss on the ground that no claim upon which relief may be granted has been stated. The facts well pleaded in the complaint and inferences therefrom are deemed admitted for the purposes of a motion for judgment on the pleadings. *Brown v. Bullock,* 194 F. Supp. at 210. A reading of the amended complaints together with exhibits [R. 85-87, 4-21; 326-328, 305-322; 357-359, 336-353], in light of the applicable substantive law hereinafter discussed, compels the conclusion that such a motion should properly have been denied.

The policy of the courts is to dispose of law suits on their merits whenever possible rather than on motions for summary judgment or judgments on the pleadings. *Tuolumne Gold Dredging Corp. v. W. W. Johnson Co.*, 61 F. Supp. 62, 63 (N.D. Cal. 1945).

II.

In Light of Supreme Court Decisions Requiring Ordinary Income Treatment of the Everyday Operations of a Business, Summary Disposition of These Suits for Refund Is Error.

(A) Because There Are Genuine Triable Issues of Material Fact;

(B) Because to Decide These Cases the Trier of Fact Must Draw Inferences of Fact to Determine the Taxpayer's Subjective Intent and Motives.

A jury trial was timely demanded in each of the instant actions. [R. 3, 304, 335.] In order for this Court to determine whether the plaintiff should have been afforded a jury trial instead of summarily being denied its day in court, a review of the statutory provisions as interpreted by the Supreme Court of the United States is essential.

In general, the Internal Revenue Code imposes an ordinary income tax on the profits derived from carrying on a trade or business, regardless of whether the regular business income is compensation for services, rental income, or proceeds from the sale of property. However, the Code generally gives special treatment to gains derived from sales of property outside the scope of normal business operations, on the theory that they are usually the result of a long-term passive investment.

If a taxpayer regularly purchases items for resale, it is clear that its business profits derived from sales of such items will be taxed as ordinary income. "Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss," and that only those transactions "which are not the normal source of business income" would be taxed as capital gain. *Corn Products Co. v. Com'r,* 350 U.S. 46, 52, *reh. denied,* 350 U.S. 943.

The term "capital gain" has been used in the law for so long that we viscerally feel that the statutory definition thereof provides a readily ascertainable yardstick for determining the applicability and scope thereof. The Code defines "capital gain" in terms of the "sale or exchange of a capital asset." Internal Revenue Code §1222. Congress in §1221(1) phrased the definition of "capital asset" to include all property, excluding therefrom among other things:

> "stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of a taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business . . .".

Despite these deceptively simple words by which Congress has attempted to exclude from "capital gain" all of those profits which it regards as the everyday profits of the business world, the Supreme Court has repeatedly been called upon to delineate the ambit of these provisions.

The Supreme Court has made it clear that ordinary business profits cannot be converted to, and taxed as, capital gains. If "necessary to effectuate the basic con-

gressional purpose, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly." In no event may "the capital-asset provision . . . be so broadly applied as to defeat rather than further the purpose of Congress." *Corn Products Co. v. Com'r, supra,* 350 U.S. at 52. Whenever possible the Court has read the statutory exclusions broadly, so as to exclude "profits . . . arising from the everyday operation of a business." Even when this was not possible the Court has denied capital gain to such profits by narrowly reading the definition of a capital asset. See *Malat v. Riddell,* 383 U.S. 569 (1966); *United States v. Midland-Ross Corp.,* 381 U.S. 54 (1965); *Com'r v. Gillette Motor Co.,* 364 U.S. 130 (1960); *Com'r v. P. G. Lake, Inc.,* 356 U.S. 260 (1958); *Corn Products Co. v. U.S.,* 350 U.S. 46 (1955); *Watson v. Com'r,* 345 U.S. 544 (1953); *Burnet v. Harmel,* 287 U.S. 103 (1932); *Hort v. Com'r,* 313 U.S. 28 (1941).

In the *Midland-Ross* case, the Supreme Court held (381 U.S. at 56) that original issue discount measured by the gain on sale of non-interest bearing promissory notes was taxable as ordinary income and not capital gain. Although such original issue discount becomes property when the obligation falls due,

> " 'not everything which can be called property in the ordinary sense and which is outside the statutory exclusions qualifies as a capital asset. This Court has long held that the term "capital asset" is to be construed narrowly in accordance with the purpose of Congress to afford capital gains treatment only in situations typically involving the realization of appreciation in value accrued over a substantial period of time, and thus to ameliorate the hardship of taxation of the entire gain in one year.' *Commissioner v. Gillette Motor Co.,* 364 U.S. 130, 134."

The recent *Malat* and *Clay Brown* decisions reiterated the foregoing concept. (*Malat,* 383 U.S. at 572; *Com'r v. Brown,* 380 U.S. 563, 572.)

Concededly none of these Supreme Court decisions is on all fours with the instant actions. In the *Corn Products* case, *supra,* the Court held that where a taxpayer purchased and sold corn futures as an integral part of its manufacturing business to protect itself against a rise in the price of corn, gains and losses from such sales gave rise to ordinary income and ordinary losses. If a sale in the furtherance of a business and as an integral part of the business yields ordinary income, *a fortiori* any of the multitudinous sales constituting the business itself must yield ordinary income. See, *Hallcraft Homes, Inc. v. Com'r,* 336 F. 2d 701, 705 (9th Cir. 1964). In *Gillette Motor, supra,* the Court held that "capital asset" does not include compensation awarded a taxpayer as representing the fair rental value of its facilities during the period of their operation under government control. The amount of the proceeds of the sale of an orange grove attributable to the value of an unmatured annual crop was treated as ordinary income in *Watson v. Com'r, supra.* Oil payment rights in *Com'r v. P. G. Lake, Inc., supra,* and payments in lieu of rent on cancellation of an unexpired lease in *Hort v. Com'r, supra,* were similarly held to be ordinary income.

Although each of the foregoing decisions is factually distinguishable from the actions at bar, the trend of the Supreme Court's pronouncements is patently in the direction here urged, viz. the everyday operations of a business enterprise yield ordinary income and loss. Both the majority opinion by Justice White and the dissent by Justice Goldberg in the *Brown* case, *supra,* were prem-

ised on the statutory provisions not "being designed to allow capital gain treatment for the recurrent receipt of commercial or business income." 380 U.S. at 572, 584.

The application of these criteria and the ambit of the capital gains provisions is a question of fact. This Court has repeatedly so held. *Austin v. Com'r,* 263 F. 2d 460, 461 (9th Cir. 1959). In *Wineberg v. Com'r,* 326 F. 2d 157, 160 (9th Cir. 1963), this Court said:

> "The Tax Court held that during the taxable years in question the taxpayer was engaged in the trade or business of selling timber. We agree with the Tax Court that what constitutes a trade or business is a question of fact."

In order for the trier of fact to resolve the instant controversy, there must be a determination of the following material issues of fact [R. 229]:

(1) what was the everyday operation of plaintiff's business from and after April, 1961?

(2) what activities did plaintiff engage in in the pursuit of its securities' business?

(3) whether plaintiff maintained inventories of securities?

In this case, the parties have never reached a stipulation of facts, nor has the lower court entered a Pre-Trial Conference Order pursuant to Fed. R. Civ. P. 16 anl Local Rule 9 of the Rules for the Southern District of California. Although the parties did attempt to achieve such an objective pursuant to these rules, the Minute Order of April, 1965 [R. 168] reflects the lower court's frustration in that respect, and the parties were ordered to proceed to trial on September 21, 1965 without a pre-trial order or stipu-

lation of facts. Prior to the hearing on April 28, 1965 and pursuant to the court's order, the parties had filed their versions of all the issues of fact to be incorporated into a Pre-Trial Conference Order.

The plaintiff filed its "Proposed Amendment to Proposed Pre-trial Conference Order re Issues of Fact" on April 21, 1965. [R. 157A.] It reflects as issues four facts to which the defendant would not agree, but which would not be contested by evidence to the contrary. [R. 157B.] In addition, twenty other issues of fact on which no agreement could be reached with the defendant were set forth. [R. 157B-C.]

On April 22, 1965 the Government filed its "Proposed Issues of Fact" setting forth twenty-nine issues of fact to be litigated. [R. 158-165.]

None of these issues was resolved at the hearing thereon on April 28, 1965, and the actions were ordered to trial without any agreement as to facts or issues. [R. 168.] Between that time and the end of June 1965, no stipulations were reached. [R. 229.] In the interim the defendant filed its motion for summary judgment on June 17, 1965 [R. 186], based *only* on the pleadings, the Greenwald affidavit, and the supporting memorandum. The complaints and answers alone raise sufficient issues to justify denial of the motion, and these issues would not be resolved by the Greenwald affidavit even if consideration of that affidavit by the court had been proper. Apparently, in denying plaintiff's Motion to Vacate the Decision [R. 275-6], the court also improperly considered the requests for admissions and interrogatories and answers thereto filed by both parties, in addition to the Greenwald affidavit in support thereof and the Wood-

man affidavit [R. 257-9] in opposition thereto, as well as the depositions on file.

Since the motion for summary judgment was based only on the pleadings, the Greenwald affidavit, and supporting memorandum, since the Greenwald affidavit was deficient under Rule 56(e), and since the depositions, the requests for admissions and interrogatories and answers thereto are not "pleadings", no consideration should have been given to these documents upon the motion. It is submitted that the court should have ruled on the motion giving consideration only to the pleadings (the complaints and answers) and the memorandum, and, based thereon, denied the motion.

Assuming, for the sake of argument only, that the court was justified in considering the other papers which it apparently considered, it is submitted that the court erred both in fact and law in reaching its decision. The Decision erroneously assumes that all items claimed in the pleadings have been resolved except [R. 236]:

1. whether the 1962 loss of $905,861.47 was an ordinary business loss and not a capital loss;
2. whether the securities on hand on October 31, 1961 were a form of inventory;
3. whether the federal stock transfer tax is a business expense.

There is no justification whatsoever for such an assumption nor is there anything in the record to support it.

As these three actions are for refund of income taxes paid, the burden is on the plaintiff to prove its total income and expenses to sustain the overpayment of taxes urged. As the defendant has urged in *Roybark v. U.S.*,

218 F. 2d 164, 166 (9th Cir. 1954) and in many other refund suits:

> ". . . an action to recover taxes is in the nature of an action for money had and received, and the taxpayer must show the tax was overpaid. The principle relied on by the Government appears to be settled law."

There is nothing before the Court by which it can determine whether the amounts of the summary judgments are correct or not. In an attempt to eliminate any issue with respect to the income and expenses aside from dealings in securities for the loss years and the income and expenses aside from any net operating loss deduction for the years sued upon, plaintiff requested defendant to admit:

(1) that for the 1958 fiscal year "The correct net taxable income for said year was $282,673.87 before deducting any net operating loss deduction." [R. 55.] Such a request serves to narrow the issue to one of determining the amount of any carry-backs and carryovers from other years to said year in order to arrive at the net operating loss deduction for 1958. Internal Revenue Code, §172(a). Defendant would only admit [R. 67] that "the correct net taxable income for fiscal year ended October 31, 1958 was $282,673.87, before considering the net operating loss carry-back of $186,229.90 generated from fiscal year ended October 31, 1961."

(2) that for the 1959 fiscal year "The correct net taxable income for said year was $499,596.76 before deducting any net operating loss deduction." [R. 56.] Defendant would only admit [R. 69] that "the correct net taxable income for fiscal year ended October 31, 1959 was $499,596.76 before considering the net operating

loss carry back of $109,615.78 generated from fiscal year ended October 31, 1962." This again is an illusory admission and does not relieve plaintiff of proving all its deductions.

(3) that for the 1960 fiscal year "The correct net taxable income for said year was $545,245.60 before deducting any net operating loss deduction." [R. 56.] This was denied by defendant. [R. 71.]

(4) that for the 1961 fiscal year "The operating loss for said year was $194,522.36 before considering the additional net losses from dealings in securities." [R. 57.] This was denied by defendant. [R. 91.]

(5) that for the 1962 fiscal year "The operating loss for said year was $139,609.21 before considering the additional net losses from dealings in securities." [R. 57-8.] This was denied by defendant. [R. 92.]

Thus, neither Greenwald's affidavit nor any admission or answer to interrogatory supplies the Court with the information necessary to determine the correct amount of the income and deductions from which the correct tax can be computed. This problem was first brought to the lower court's attention in the Plaintiff's Statement of Genuine Issues [R. 229, line 17.] There is no doubt that if the defendant would not admit the foregoing, it does constitute a triable issue of fact, necessary for the computation of any overpayment of tax under the *Roybark* decision. As the lower court pointed out at 164 F. Supp. 759, 762 (S.D. Cal. 1952):

> "Not only must the plaintiff show that the Commissioner was wrong, but he must go further and establish the essential facts from which a correct determination of his tax liability can be made.

> Lewis v. Reynolds, 284 U.S. 281, 283, 52 S.Ct. 145, 76 L.Ed. 293; Forbes v. Hassett, 1 Cir., 124 F.2d 925, 928; Harvey v. Early, 4 Cir., 189 F.2d 169; Swift Mfg. Co. v. U. S., 12 F.Supp. 453, 456, 81 Ct.Cl. 932. The taxpayer must show that he has overpaid his tax and that involves a redetermination of his entire tax liability. Globe Gazette Printing Co. v. U. S., 13 F.Supp. 422, 425, 82 Ct.Cl. 586. He must show the exact amount to which he is entitled. Helvering v. Taylor, 293 U.S. 507, 514, 55 S.Ct. 287, 79 L.Ed. 623."

For the 1961 fiscal year, the defendant raised an issue which would affect the amount of the net operating loss deduction for the 1958 fiscal year. In its Answer to the First Amended Complaint in action 64-693 [R. 329], the defendant urged as an affirmative defense [R. 330-1] that the 1961 corporate gross income was understated by $88,564 as the result of failing to report the entire consideration received on the sale of the sliding glass door business. The defendant was requested to admit [R. 56] that "In April, 1961 the taxpayer sold all of its assets to Cal-Tech Systems and received in cash the sum of $1,041,271.00 which it reported in its tax return." Defendant denied that this was the sum received. [R. 71.] In plaintiff's Statement of Genuine Issues, plaintiff posed as a triable issue of fact: "whether plaintiff reported the correct proceeds from the sale of its sliding door business in April, 1961?" [R. 229.] Only after the Court on August 30, 1965 rendered decision in defendant's favor did defendant in its Opposition to the Motion to Vacate the Decision then "acknowledge" that this amount constitutes the correct proceeds from the sale. [R. 256H.]

Similarly with respect to plaintiff's genuine issues 7 and 8 [R. 229], only after the court's Decision, did defendant decide not to contest these issues as set forth in its Memorandum in Opposition to the Motion to Vacate the Decision. [R. 256G.] Prior to the filing of this Memorandum on September 9, 1965 [R. 256A] neither the plaintiff nor the lower court could have known that the defendant would change its position.

this, no stipulation could be reached in this respect, and even at the time the court's decision on the motion for summary judgment was filed, these were genuine triable issues of fact among others hereinafter discussed in addition to those posed by the lower court. [R. 236.] It is submitted that the motion for summary judgment should have been denied based on the foregoing in light of the judicial construction of Fed. R. Civ. P. 56.

> "On appeal from an order granting a defendant's motion for summary judgment the circuit court of appeals must give the plaintiff the benefit of every doubt." *Sprague v. Vogt,* 150 F. 2d 795, 800 (8th Cir. 1945).

This Court, in *Griffith v. Utah Power & Light Co.*, 226 F. 2d 661, 669 (9th Cir. 1955), concisely set forth the criteria which a trial court should use where there has been a demand for jury trial:

> "The federal Constitution gives a right of jury trial in a contested issue in a law action. This right is positive and should not be whittled away by decision of contested issues by the judge at hearings in camera before trial. The summary judgment rule does not confer this power even in a non-jury case. The remedy can be invoked only when complete absence of genuine fact issue appears on the face of the record. Resort to summary judgment proce-

dure is futile where there is any doubt as to whether there is a fact issue. All doubts upon the point must be resolved against the moving party. This Rule, on account of these limitations, was not intended to be used as a substitute for a regular trial of cases where 'there are disputed issues of fact upon which the outcome of the litigation depends.' This procedure is not, and of right ought not to be, a substitute for a trial by jury or judge."

As in *New and Used Auto Sales v. Hansen,* 245 F. 2d 951, 952 (9th Cir. 1957),

"The trial court here attempted to use summary judgment procedure to supply the place of pleadings and of trial. The efficiency of this device to eliminate from congested trial dockets cases in which there is no substantial dispute of fact is not denied, nor could it be. But this circumstance cannot be used as an excuse to hear and determine causes which are not before the court by pleading or otherwise."

In light of the numerous hearings reflected in the docket entries, it is not surprising that the lower court observed that more time has been wasted in these matters on preliminary motions, hearings, attempts at pretrial, etc. than it would have taken to try them. [R. 264.] However true this may be, it constitutes no reason for a trial by affidavit.

"TRIAL BY AFFIDAVIT IS NO SUBSTITUTE FOR TRIAL BY JURY WHICH SO LONG HAS BEEN THE HALLMARK OF 'EVEN HANDED JUSTICE'" *Poller v. Col. Broad. System,* 368 U.S. 464, 473 (1962).

"Rule 56(c), Fed. R. Civ. P., 28 U.S.C.A., provides that a motion for summary judgment should be granted 'if the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.' Standards for the application of this rule have been thoroughly developed by this court. (citations) While it is the duty of the trial court to grant a motion for summary judgment in an appropriate case, the relief contemplated by Rule 56 is drastic and should be applied with caution to the end that the litigants will have a trial on bona fide factual disputes. Under the rule no margin exists for the disposition of factual issues, nad it does not serve as a substitute for a trial of the case nor require the parties to dispose of litigation through the use of affidavits. The pleadings are to be construed liberally in favor of the party against whom the motion is made, but the court may pierce the pleadings, and determine from the depositions, admissions and affidavits, if any, in the record whether material issues of fact actually exist. If, after such scrutiny, any issue as to a material fact dispositive of right or duty remains the case is not ripe for disposition by summary judgment, and the parties are entitled to a trial." *Bushman Const. Co. v. Conner,* 307 F. 2d 888, 892 (10th Cir. 1962).

". . . it is also a maxim that the court, on a motion for summary judgment, cannot *try* issues of fact but can only determine whether there *are* issues of fact to be tried; and, once having deter-

mined this affirmatively must leave those issues for determination at a trial." *Empire Electronics Co., Inc. v. U.S.A.*, 311 F. 2d 175, 179 (2d Cir. 1962).

"And all reasonable doubts touching the existence of a genuine issue as to a material fact must be resolved against the party moving for summary judgment." *Traylor v. Black, Sivalls & Bryson, Inc.*, 189 F. 2d 213, 216 (8th Cir. 1951).

In *Knapp v. Kinsey*, 249 F. 2d 797, 801 (6th Cir. 1957), the court pointed out that

"In Begnaud v. White, 6 Cir., 170 F. 2d 323, 327, we said, 'The authorities indicate that the trial judge should be slow in passing upon a motion for summary judgment which would deprive a party of his right to a trial by jury where there is a reasonable indication that a material fact is in dispute,' citing Sartor v. Arkansas Natural Gas Corp., 321 U.S. 620. In Lloyd v. United Liquor Corp., 6 Cir., 203 F. 2d 789, 793, we quoted with approval from the opinion in Doehler Metal Furniture Co. v. United States, 2 Cir., 149 F.2d 130, 135, as follows, 'We take this occasion to suggest that trial judges should exercise great care in granting motions for summary judgment. * * * Such a judgment, wisely used, is a praiseworthy and time-saving device. But, although prompt despatch (sic.) of judicial business is a virtue, it is neither the sole nor the primary purpose for which courts have been established. Denial of a trial on disputed facts is worse than the delay.' Other cases in which we held that summary judgment proceedings did not afford the losing party an adequate opportunity to develop

the facts and should not have been used are Estepp v. Norfolk & Western Railway Co., 6 Cir., 192 F. 2d 889; Bellak v. United Home Life Insurance Co., 6 Cir., 211 F.2d 280, 283, and Hoy v. Progress Pattern Co., 6 Cir., 217 F.2d 701, 704."

In *Kennedy v. Silas Mason Co.,* 334 U.S. 249, 256 (1947), the Supreme Court pointed out that

> "summary procedures, however salutary where issues are clear-cut and simple, present a treacherous record for deciding issues of far-flung import, on which this Court should draw inferences with caution from complicated courses of legislation, contracting and practice.
>
> "We consider it the part of good judicial administration to withhold decision to the ultimate questions involved in this case until this or another record shall present a more solid basis of findings based on litigation or on a comprehensive statement of agreed facts."

Based on what the lower court had before it in determining the motion for summary judgment, there is no doubt that inferences were drawn despite the paucity of facts before the court. It is submitted that there was nothing before the lower court bearing on the plaintiff's intent in the purchase and sale of securities. In *Poller v. Columbia Broadcasting System, supra,* 368 U.S. at 473, the Supreme Court concluded that:

> "We believe that summary procedures should be used sparingly * * * where motive and intent play leading roles, the proof is largely in the hands of

> the alleged conspirators, and hostile witnesses thicken the plot. It is only when the witnesses are present and subject to cross-examination that their credibility and the weight to be given their testimony can be appraised."

In *Cross v. United States,* 336 F. 2d 431, 433 (2d Cir. 1964), the like principle was aptly expressed as follows:

> "Summary judgment is particularly inappropriate where 'the inferences which the parties seek to have drawn deal with questions of motive, intent and subjective feelings and reactions.' Empire Electronics Co. v. United States, 311 F.2d 175, 180 (2d Cir. 1962); See Alabama Great So. R.R. v. Louisville & Nashville R.R., 224 F. 2d 1, 5 (5th Cir. 1955); Subin v. Goldsmith, 224 F. 2d 753, 758 (2d Cir. 1955).' 'A judge may not, on a motion for summary judgment, draw fact inferences. * * * Such inferences may be drawn only on a trial.' Bragen v. Hudson County News Co., 278 F. 2d 615, 618 (3d Cir. 1960)."

Even where the underlying physical data are not in dispute, the court cannot, on motion for summary judgment, determine the intention of the parties concerning transfer of title. *Empire Electronics Co. v. United States,* 311 F. 2d 175, 178 (2d Cir. 1962). The inferences of fact to be drawn from such evidentiary facts are disputed and present a genuine issue as to a material fact. *Ibid.*

> "And the courts have often held that genuine issues of material fact exist, within the meaning of

the summary judgment rule, where, as here, reasonable men differ about the inferences to be drawn from undisputed basic facts."

Tanaka v. Im. & Nat. Serv., 346 F. 2d 438, 447 (2d Cir. 1965);

Buren v. Schein, 32 F.R.D. 218, 220 (E.D. N.Y. 1963) [citing Empire Electronics];

Winter Park Tel. Co. v. So. Bell Tel & Tel. Co., 181 F. 2d 341 (5th Cir. 1950).

The plaintiff here urged to the lower court as genuine issues [R. 229]:

"3. what was plaintiff's intent in the acquisition and disposition of securities?

4. what plaintiff's everyday operation of its business was?

5. what activities plaintiff engaged in in pursuit of its securities business?"

This Statement of Genuine Issues [R. 229] was filed pursuant to Local Rule 3(d)(2) for the Southern District of California which provides in pertinent part:

"Any party opposing the motion may, not later than three days prior to the hearing, serve and file a concise 'statement of genuine issues' setting forth all material facts as to which it is contended there exists a genuine issue necessary to be litigated."

The record is almost barren of anything bearing on these issues and the only findings of fact remotely touching thereon are Paragraphs 14, 15 and 16. [R. 282.] Even these findings are not responsive to the foregoing issues and aside from finding that plaintiff had a substantial number of stock transactions with several brokers, they are otherwise phrased in the negative.

There is nothing to indicate what the plaintiff did do, or to indicate what the plaintiff's everyday operation of its business was.

To further show that there was nothing before the court by which it could determine plaintiff's intent, plaintiff's president Gerald Woodman stated in his affidavit [R. 258] that

> "6. The taxpayer at various times made attempts to acquire large blocks of stock with a view to effecting public distribution thereof and with a view to maintaining a market therein.
>
> 7. During its 1961 fiscal year the taxpayer purchased $3,023,313.91 worth of securities which were sold for $3,039,658.41 in hundreds of different transactions. During its 1962 fiscal year the taxpayer purchased and sold in the course of its business thousands of shares of stock in several hundred different transactions. Inventories were maintained of all of such securities. During that year the taxpayer sold securities with a cost of $4,944,582.49 for $4,038,721.02.
>
> 8. During 1961-62 taxpayer was actively, directly and continuously engaged in the business of buying and selling securities, for cash and on margin, dealing in puts and calls, and selling short. Not all of taxpayer's transactions were effected through brokers. At no time did taxpayer purchase or sell any securities with an investment motive. At various times taxpayer's officers dealt directly with principals. The taxpayer had no other business activities after April, 1961."

If evidence of the foregoing were before the lower court, there is no doubt but that it would shed light on the issues before the court.

After its Decision the lower court did request counsel to advise the court of the effect on its decision, if it ignored Greenwald's affidavit. [R. 261.] It is submitted that there would have been little before the lower court if it had, and that the pleadings do not allow for the result reached.

In its Decision the lower court erroneously characterized the following italicized statements as "undisputed facts." [R. 236.] If facts not elicited from the pleadings, admissions and interrogatories were to have been deleted, as is done below, the lower court quite obviously would not have had and did not have sufficient facts from which to make ultimate findings of fact or formulate a legal conclusion as to the correctness of plaintiff's contentions. It is too clear for citation of authority that representations of fact contained in memoranda and briefs filed by counsel do not constitute admissions for the purposes of a motion for summary judgment.

> *"Prior to April, 1961, plaintiff was engaged in the business of manufacturing and selling sliding glass doors under the name of Fullview Corporation.* Source: Plaintiff's Pre-trial Memorandum [R. 135]. *In the spring of 1961 the plaintiff sold substantially all of its assets to Cal Tech Systems, Inc., receiving net cash proceeds therefor in the amount of $1,041,271.00.* Source: Greenwald Affidavit, ¶4 [R. 189]. This had been denied by defendant in response to plaintiff's Request for Admissions #9 [R. 56, 71]. *Thereafter plaintiff changed its name to Mirro-Dynamics Corporation, discontinued its sliding glass door business and applied the proceeds from the sale to the purchase*

of marketable securities. Source: Greenwald Affidavit, ¶4 [R. 189]. *During the fiscal years ending October 31, 1961, and October 31, 1962, the plaintiff purchased and sold securities and conducted other miscellaneous stock transactions solely for its own account. During these years, plaintiff had accounts with several established brokerage firms and through these bought and sold a substantial number of securities, summaries of which were recorded in plaintiff's general ledger under an account entitled 'Stock Investment Account No. 123.'* Source: Greenwald Affidavit, ¶5 [R. 189]. Plaintiff had denied Defendant's Request for Admissions #13 in this respect [R. 99, 121]. *Plaintiff filed federal income tax returns for the years ending October 31, 1961, and 1962, the latter reporting a loss of $905,861.47 from these security transaction and designating such loss as a capital loss.* Source: Greenwald Affidavit, ¶7 [R. 190]. Plaintiff had denied Defendant's Request for Admissions #2 in this respect [R. 96, 118]. *During these years neither the plaintiff nor its officers were members of any stock exchange, nor were they licensed or registered with the Securities and Exchange Commission as a broker or dealer in marketable securities, nor were they licensed or registered by the State of California to sell marketable securities to the general public."*

Although some of the foregoing unsupported facts may be immaterial, nevertheless, the lower court's decision that "under the above facts, and as a matter of law, plaintiff's loss of $905,861.47 was a capital loss" [R. 237, 283] does not withstand scrutiny. Patently

there were genuine triable issues of fact, and the summary judgments should be reversed and a jury trial had. It should be noted that nowhere in the Findings or Conclusions did the lower court conclude that there were no genuine triable issues of material fact. This alone vitiates the judgments under this Court's opinion in *New and Used Auto Sales v. Hansen, supra*, 245 F. 2d at 953 (9th Cir. 1957).

III.

A Taxpayer's Business of Buying and Selling Securities Generates Ordinary Income or Loss Even if It May Not Inventory Securities Under Internal Revenue Regulations.

The trial court bottomed its Decision on the premise that plaintiff could prevail only if it were a dealer and then concluded "as a matter of law that the plaintiff is not a dealer within the meaning of the Act." [R. 238-239.] Paragraph 2 of the Conclusions of Law provides [R. 283] that "The plaintiff is not a dealer in securities, Schafer v. Helvering, 299 U.S. 171 (1936); Commissioner's Regulations 1.471.5." There is no finding of fact that the plaintiff is or is not a dealer. [R. 277-282.]

It is submitted that the foregoing authorities bear only on the question of whether the plaintiff may inventory its securities and not on the issue of whether the business of buying and selling securities generated ordinary income or loss. Although there appears to be authority [*e.g.* the dictum in *Booth Newspapers, Inc.*, 303 F. 2d 916 (Ct. Cl. 1962) cited by the trial court [R. 238]] that only capital stock sold by dealers in the usual course of their business is not a capital asset,

this is not the law, or should not be the law, in light of recent judicial interpretations of the Internal Revenue Code. The issue relating to the question of whether the plaintiff could inventory its securities was initiated by the Internal Revenue Service itself when it maintained that since this taxpayer priced its inventories of manufactured sliding glass doors on a basis of cost or market, whichever is lower, it could not price its inventories of securities at cost, because this was an improper change of inventory pricing. [R. 259.] Whether the securities are priced at cost or market, whichever is lower, or at cost is not significant in the instant actions as the only inventory in question is as at October 31, 1961 and both the years 1961 and 1962 were before the court. If the taxpayer were required to use cost or market, whichever is lower, the closing inventory on October 31, 1961 would be lower with a concomitant reduction in 1961 income. Part of the loss from 1962 would be shifted to 1961. This would result in a larger operating loss carryback from the 1961 year to 1958, and a smaller carryback from 1962 to 1960. [See R. 87.]* As the tax rate for all years concerned its 52%, the method of inventory pricing is not materially significant. However, the trial court never discussed inventory pricing and never determined whether the plaintiff did maintain inventories of its securities. [*Cf.* R. 258, line 28.] The trial court's decision states that plaintiff's securities were not a form of "business inventory within the meaning of the Internal Revenue Act" [R. 241, line 14], whatever that means. The plaintiff at no time urged that they were

*There would be no effect on the income for 1962 or any other year, as all securities were sold in 1962 and there was no ending inventory of securities.

business inventory and merely advanced the issue raised by the Internal Revenue Service as to what was the correct method of inventory pricing. Whichever method is correct, it is submitted that it has no bearing on whether the plaintiff's securities business generated ordinary income or loss.

It is conceded that in order to inventory securities the Regulations relating to inventories prescribe that one must be a dealer within the definition there set forth. However, the last phrase of Reg. §1.471-5, and its predecessor Reg. 118, §39.22(c)-5, in substantially identical language, specifically limits the Regulations' definition of dealer as follows:

> "Taxpayers who buy and sell or hold securities for investment or speculation, irrespective of whether such buying or selling constitutes the carrying on of a trade or business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers *within the meaning of this section.*" (Italics added.)

THE INTERNAL REVENUE CODE DOES NOT, AND NEVER DID, DEFINE "DEALER" FOR THE PURPOSES OF THE BUSINESS LOSS PROVISIONS (§172) OR THE DEFINITION OF CAPITAL ASSETS (§1221). Furthermore, the Code does not provide that only dealers in securities are entitled to ordinary losses.

Whether plaintiff was a dealer within the meaning of this section of the Regulations (§1.471-5) or not, does not affect the question of whether the business of buying and selling securities generated ordinary losses, but only bears on the inventory issue. See *United*

States v. Chinook Inv. Co., 136 F. 2d 984, 985 (9th Cir. 1943).

Unfortunately many decisions determining whether securities' transactions resulted in capital or ordinary gains or losses have been premised on a trichotomy with no clearly defined boundaries and without regard to the statutory provisions. This trichotomy, dealer—trader—investor, is not delineated either in the Code or the Regulations, and means different things to different people. Some of the problems defining the status of a stockbroker, *e.g.* dealer, broker, investment adviser, etc., are discussed in Levin & Evan, "PROFESSIONALISM AND THE STOCKBROKER," XXI The Business Lawyer, 337 (Jan. 1966). It is there pointed out (p. 339) that "The stockbroker may also serve as a *dealer,* in which status he buys or sells for his own, rather than his customer's, account. In this status as a principal, his compensation will result from the profit or 'spread' which he is able to make on the various securities he sells."

Consistent with this definition is that contained in the Securities Exchange Act of 1934, 15 U.S.C.A. §78c (1963 Ed.):

> "(a) When used in this chapter, unless the context otherwise requires—
>
> * * *
>
> (5) The term 'dealer' means any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business."

Apparently the lower court premised its conclusion that the plaintiff was not a dealer on the admitted fact that plaintiff bought and sold securities solely for its own account. Findings of Fact 14 and 15 [R. 282] state that the stock transactions were solely for plaintiff's account and were through several established brokerage firms. The lower court's Decision concludes that [R. 239]

> "Since it is undisputed that the plaintiff purchased and sold securities solely for its own account and not *for* customers in the ordinary course of a trade or business or otherwise, it follows as a matter of law that the plaintiff is not a dealer within the meaning of the Act and that the securities are capital assets and may not properly be considered business inventory." (Italics added.)

Apparently the lower court was confusing the concept of "broker" with that of "dealer," as the facts found fit the Congressional definition of dealer, set forth above. 15 U.S.C.A. §78c(a)(4) (1963 Ed.) defines a broker as "any person engaged in the business of effecting transactions in securities *for* the account of others, but does not include a bank." (Italics added.) The fact that the lower court was concerned with whether it was *for* customers indicates that it did not have in mind whether the sales were *to* customers as used in Internal Revenue Code, §1221(1), which contains the statutory definition of capital asset. Whether plaintiff was a dealer or not is immaterial, in light of this Court's ruling in *United States v. Chinook Inv. Co.*, 136 F. 2d 984, 985 (9th Cir. 1943) that "The question before us relates to the status of assets rather than to the status of the taxpayer."

In that case, the taxpayer had been organized "to own, buy, sell, or to acquire" bonds, stocks, and other securities.

> "For many years it regularly followed that calling, maintaining an office for the transaction of its business and buying and selling upwards of $300,000 worth of securities yearly. Its management kept in close touch with the market, subscribed to financial periodicals, and bought and sold securities at private sale, 'at random,' 'over the counter,' and 'listed securities.' Unlisted securities dealt in were sometimes those of local companies with whose business the taxpayer was familiar. Purchases were often made direct from the owners of stock, and taxpayer was frequently approached by brokers who had securities to buy or sell. Persons or concerns believed to be interested in making sales or purchases were solicited, and securities were bought or sold when it was thought the market justified. The transactions were not on margin, but for cash, and there was a capital turnover about once each year. In the acquisition of securities, 'investment was not the idea of the Company.'" 136 F. 2d at 984.

This Court concluded that it was impossible to categorize this taxpayer definitively, despite a contention by the Government, as here, that the taxpayer was not a dealer entitled to inventory securities under *Schafer v. Helvering* and Regulation 94, Art. 22(c)-5. This regulation, the precursor of §1.471-5, was deemed irrelevant to the issue and the *Schafer* case ruled to be not decisive. Since the taxpayer was regularly engaged in the business of buying and selling stocks and bonds,

and the securities dealt in were held primarily for sale to customers in the ordinary course of the taxpayer's business and not for investment or speculation, the taxpayer's losses were not capital losses. "The statute appears to speak for itself." 136 F. 2d at 985.

Aside from the issue regarding securities' inventory, the pertinent language of the statute, §1221(1), insofar as this taxpayer is concerned, excludes from the definition of capital assets:

> "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

Each phrase in this exclusionary clause bears analysis.

A. PROPERTY Held by the Taxpayer Primarily for Sale to Customers in the Ordinary Course of His Trade or Business.

In the *Chinook Inv.* case, *supra,* this Court held (136 F. 2d at 985) that securities were "property" within the meaning of the predecessor of §1221(1), §117(b).

B. Property Held by the Taxpayer Primarily for Sale to Customers in the Ordinary Course of His TRADE or BUSINESS.

Congress has not defined the phrase "trade or business." See *Kales v. Com'r,* 101 F. 2d 35, 37, 38 (6th Cir. 1939), cited in *Miller v. Com'r,* 102 F. 2d 476, 480-481 (9th Cir. 1939). "Despite statements that the words 'trade or business' have 'many shades of meaning, and are subject to colloquial abuses,' Hughes v. C.I.R., 38 F.2d 755, 759 (10 Cir. 1930), the courts, quite understandably, have not regarded the various sections of the Code using that term as water-tight com-

partments." *Trent v. Com'r,* 291 F. 2d 669, 671 (2d Cir. 1961).

Although the findings of fact do not reflect the taxpayer's trade or business, the lower court's Decision indicates that the judge apparently felt [R. 243] that the taxpayer was "engaged in the business of buying and selling securities on its own behalf" and was "at the most a trader on his (sic) own account."

However, it is the law of this Circuit, based on *Stone v. United States,* 164 U.S. 380, 383, that:

> ". . . when the trial court does make formal findings, they alone serve as the court's findings of fact. In the words of the Supreme Court: 'We are not at liberty to refer to the opinion for the purpose of eking out, controlling or modifying the scope of the findings.' " *Ohlinger v. United States,* 219 F. 2d 310, 311 (9th Cir. 1955).

Accordingly, there is nothing in the record (*United States v. U.S. Gypsum Co.,* 51 F. Supp. 613, 634 (D.C. D.C. 1943)) determining what the taxpayer's business was. Apparently, the defendant took the position in its motion for summary judgment that "Whether or not the plaintiff was in the business of buying and selling securities *per se* is not material to a determination of whether or not its securities were capital assets." [R. 205.] Yet, after the lower court's Decision was filed, the defendant apparently "acknowledged" in its Memorandum in Opposition filed September 9, 1965,* that

*Prior to the lower court's Decision and this "acknowledgement," there was nothing before the court from which it could determine the taxpayer's motives and intent in order to satisfy the criteria set forth in the very case which the trial court cited [R.

[R. 256H] "plaintiff was in the business of buying and selling marketable securities for a profit" and conceded the veracity of plaintiff's response to Interrogatory 12 [R. 125]:

> "The purpose of plaintiff's purchases and sales of securities, puts and calls, and rights to purchase securities was in each instance in furtherance of its business, the business of buying and selling securities to make a profit as soon as possible. The plaintiff at no time purchased or sold securities with an investment motive . . ."

The cases discussing what activities will result in the status of a trade or business have yielded myriad criteria for the various sections of the Code, requiring such a determination.

As early as 1931, the Commissioner of Internal Revenue ruled in Mim. 3883, X-2 Cum. Bull. 180, that "Whether or not a taxpayer's activities, and particularly his activities involving stock market transactions, constitute a 'trade or business' as that term is contemplated by the statutory provisions is purely a question of fact in each case, and no general rule can be laid down which would be determinative of this issue in all cases in which the question arises." Among the cases cited by the Commissioner was *Ignaz Schwinn,* 9 B.T.A. 1304 (1928), *acq.* VII-1 Cum. Bull. 28, in

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238], *Booth Newspapers, Inc. v. U.S.,* 303 F. 2d 916, 921 [Ct. Cl. 1962]:

> "Thus the circumstances of the transaction (its factual background, the necessities of the particular business involved at the particular time involved, and the intentions of the taxpayer, both at the time the securities were originally purchased and at the time they were disposed of) are of crucial importance in the resolution of these cases. The fact that securities are 'property,' in the broad sense of that term, is not conclusive."

which it was held that where the taxpayer devoted the largest part of his business time to, and made the most money from, speculating in stocks, grain and other commodities, and had large sums of money involved in his margin dealings, having had 112 transactions in commodities and 15 in securities in 1923, and 91 transactions in commodities and 30 in securities in 1924, the taxpayer's loss resulting from the purchase and sale of 2,300 shares of Anaconda copper stock was a loss sustained in 1924 with respect to property held primarily for sale in the course of the taxpayer's trade or business and not a capital loss. In *Snyder v. Com'r,* 295 U.S. 134 (1935), *reh. den.* 55 S. Ct. 913, the Supreme Court indicated that, although in that case the taxpayer did not allege or attempt to prove that he had devoted the major part, or any substantial part, of his business day to his transactions, if he had done so the result of the case might have been different. The Court stated: "It is also true that the Department has ruled, and the board has held, that a taxpayer who, for the purpose of making a livelihood, devotes the major portion of his time to speculating on the stock exchange may treat losses thus incurred as having been sustained in the course of a trade or business," citing *Ignaz Schwinn, supra.* The taxpayer should at least be allowed to prove its activites in this regard, and not be summarily denied this opportunity by having the case decided on a motion for summary judgment.

This Court, in *Maloney v. Spencer,* 172 F. 2d 638, 640 (9th Cir. 1949), spelled out the criteria for determining the taxpayer's business status as follows:

> "Here the taxpayer's activities were 'extensive, varied, continuous and regular' as in Daily Journal

Co. v. Commissioner, 9 Cir., 135 F. 2d 687, 688, and Miller v. Commissioner, 9 Cir., 102 F. 2d 476. Here is the 'frequency and continuity of the transaction' resulting in a business status of Commissioner v. Boeing, 9 Cir., 106 F. 2d 305, 319, certiorari denied 308 U.S. 619, 60 S. Ct. 295, 84 L. Ed. 517. Here the taxpayer was engaged in two businesses as in Daily Journal Co. v. Commissioner, supra, 135 F. 2d 689, and Harvey v. Commissioner, 9 Cir., 171 F. 2d 952. Like the instant case are Fackler v. Commissioner, 6 Cir., 133 F. 2d 509; Kales v. Commissioner, 6 Cir., 101 F. 2d 35, 122 A.L.R. 211; Foss v. Commissioner, 1 Cir., 75 F. 2d 326.

"Here is the 'regularity' as distinguished from the 'isolated or occasional transactions' of Burnet v. Clark, 287 U.S. 410, 424, 425, 53 S. Ct. 207, 77 L. Ed. 397 and Dalton v. Bowers, 287 U.S. 404, 53 S. Ct. 205, 77 L. Ed. 389. Also is the multiplicity of transactions required by the several leases creating a business obligation to the corporations as distinguished from the 'single transaction' occurring in the 'lifetime' of the taxpayer 'but once' of Deputy v. DuPont, 308 U.S. 488, 495, 60 S. Ct. 363, 84 L. Ed. 416."

". . . one may be 'regularly engaged in the business of buying and selling corporate stocks.'" *Snyder v. Com'r*, 295 U.S. 134, 139 (1935). "A trader on an exchange, who makes a living in buying and selling securities or commodities, may be said to carry on a 'business';" *Bedell v. Com'r*, 30 F. 2d 622, 624 (2d Cir. 1929). For the purpose of determining the taxability of non-resident aliens, the courts have generally held

that "extensive trading in stocks and commodities constituted engaging in trade or business within the meaning of the statute. See Snyder v. C.I.R., 295 U.S. 134, 139, 55 S. Ct. 737, 79 L. Ed. 1351; Field v. C.I.R., 2 Cir., 139 F. 2d 465; Adda v. C.I.R., 10 T.C. 273, affirmed, 4 Cir., 171 F. 2d 457, certiorari denied 336 U.S. 952, 69 S. Ct. 883, 93 L. Ed. 1107;" *Com'r v. Nubar,* 185 F. 2d 584, 588 (4th Cir. 1950).

Although the *Adda* case cited in *Nubar* involved commodities and not stocks, the language of the Tax Court, 10 T.C. 273, 277, affirmed per curiam, 171 F. 2d 457 (4th Cir. 1948) cert. denied 336 U.S. 952, shows that the Government there urged the position taken by this taxpayer:

> "Trading in commodities for one's own account for profit may be a 'trade or business' if sufficiently extensive. Fuld v. Commissioner, 139 F. 2d 465; Norbert H. Wiesler, 6 T.C. 1148, affirmed without discussion of this point 161 F. 2d 997. The respondent determined that the petitioner was engaged in trade or business in the United States. While the number of transactions or the total amount of money involved in them has not been stated, it is apparent that many transactions were effected through different brokers, several accounts were maintained, and gains and losses in substantial amounts were realized. This evidence shows that the trading was extensive enough to amount to a trade or business, and the petitioner does not contend, nor has he shown that the transactions were so infrequent or inconsequential as not to amount to a trade or business."

In *Fuld v. Com'r,* 139 F. 2d 465, 469 (2d Cir. 1943), the court concluded that

> "it may fairly be said that persons engaged in speculating through brokers whether in merchandise or in securities may equally hold themselves out as engaged in business. We so held in Winmill v. Commissioner, 2 Cir., 93 F. 2d 494, and while that decision was reversed in Helvering v. Winmill, 305 U.S. 79, 59 S. Ct. 45, 83 L. Ed. 52, the reversal was only on the ground that brokers' commissions in such a business were to be treated as part of the price of securities rather than as a current expense of the business. See also, Neuberger v. Commissioner, 2 Cir., 104 F. 2d 649, reversed on other grounds, 311 U.S. 83, 61 S. Ct. 97, 85 L. Ed. 58. The Supreme Court in Spreckels v. Commissioner, 315 U.S. 626, 62 S. Ct. 777, 86 L. Ed. 1073, apparently assumed that a taxpayer buying and selling securities on his own account was engaged in a trade or business, through there again the critical question was whether the commissions paid a broker by one speculating on his own account were part of the cost of the securities or a business expense."

This Court in numerous instances has had occasion to consider what is a trade or business in connection with other "property," viz. real estate. In *Pool v. Com'r,* 251 F. 2d 233, 235 (9th Cir. 1957), *cert. denied,* 356 U.S. 938, this Court cited from *Stockton Harbor Ind. Co. v. Com'r,* 216 F. 2d 638, 650 (9th Cir. 1954):

> "What is and what is not trade or business and when property is or is not held for sale to customers are questions of fact.

"Provisions similar to the one under discussion have been part of our tax statutes for many years. Courts have sought to evolve criteria by which to determine whether a person or an association was engaged in business. More particularly, they have tried to establish criteria by which to determine whether real property is held for investment or sale to customers in the ordinary course of business. Many tests have been proposed by this and other courts. Among them are: (1) the nature of the acquisition of the property, (2) frequency and continuity of sales over a period of time, (3) the nature and extent of the taxpayer's business, (4) the activity of the seller about the property, such as the extent of his improvements or his activity in promoting sales, (5) the extent and substantiality of the transaction and the like. * * * But in the last analysis, each case must be determined upon its own specific facts, for none of these incidences are present in all cases."

There is no doubt but that this Court's decisions compel the conclusion that §1221(1) must be consistently construed by this Court irrespective of the nature of the property under consideration, whether securities, cattle, hogs, or real property. *United States v. Chinook Inv. Co., supra,* 136 F. 2d at 985 (9th Cir. 1943). One of the earliest decisions from this Court on business status was *Com'r v. Boeing,* 106 F. 2d 305 (9th Cir. 1939), *cert. denied,* 308 U.S. 619, involving the question of whether the taxpayer was in the business of selling logs. This Court concluded at page 309 that "the facts necessary to create the status of one engaged in a 'trade or business' revolve largely around the frequency or

continuity of the transactions claimed to result in a 'business' status."

The legislative history of this section is necessary to orient the Court as various decisions have dealt with predecessor sections as amended from time to time.

Prior to 1921 there was no provision in the income tax law for extraordinary treatment of gains from the sale of capital assets. The Revenue Act of 1921 added a section defining capital assets as "property acquired and held by the taxpayer for profit or investment for more than two years . . . but does not include . . . stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer. . ." §206(a)(6), Act of November 23, 1921, c. 136, 42 Stat. 227, 232. The result of this addition was to grant preferential treatment to sales of certain assets excluding property which under the best accounting practice for the particular trade or business in question would be considered stock in trade or inventory items. H. Rep. No. 350, 67th Cong., 1st Sess., pp. 10-11 [1939-1 Cum. Bull. (Part 2) 176]; S. Rep. No. 275, 67th Cong., 1st Sess., pp. 12-13 [1939-1 Cum. Bull. (Part 2) 189-190]. Since real estate would not ordinarily be included in an inventory, it did not fall into the exclusion and gains from the sale thereof would always be capital gains.

In 1924 the definition of capital assets was amended by adding to the excluded items "property held by the taxpayer primarily for sale in the course of his trade or business." Rev. Act of 1924, §208(a)(8), Act of June 2, 1924, c. 234, 43 Stat. 253. The purpose of this amendment was said to be "to remove any doubt as to whether property which is held primarily for resale con-

stitutes a capital asset, whether or not it is the type of property which under good accounting practice would be included in the inventory." H. Rep. No. 179, 68th Cong., 1st Sess. p. 19 [1939-1 Cum. Bull. (Part 2) 255]; S. Rep. No. 398, 68th Cong., 1st Sess., p. 22 [1939-1 Cum. Bull. (Part. 2) 281]. Under this version of the statute a taxpayer carrying on "business through agents whom he supervises" for the purpose of selling land, was held to have ordinary gain from sales of land which had been held primarily for sale in the course of his business. *Snell v. Com'r*, 97 F. 2d 891, 893 (5th Cir. 1938); *Richards v. Com'r*, 81 F. 2d 369 (9th Cir. 1936).

If Appellant were afforded an opportunity to lay before a jury the extent of its *only* activities during the period in question, it could clearly establish that its trade or business was buying and selling securities. See, *Kelley v. Com'r*, 281 F. 2d 527, 529 (9th Cir. 1960).

C. Property Held by the Taxpayer Primarily for Sale to CUSTOMERS in the Ordinary Course of His Trade or Business.

In 1934 Congress amended the statutory exception to read "property held by the taxpayer primarily for sale *to customers* in the *ordinary* course of his trade or business." Revenue Act of 1934, §117(b), Act of May 10, 1934, c. 277, 48 Stat. 680 (words in italics added in 1934). According to the House Conference report, this was done to make "it impossible to contend that a stock speculator trading on his own account is not subject to the provisions of section 117." H. Conf. Rep. No. 1385, 73rd Cong., 2nd Sess., p. 22 (Amend. No. 66) [1939-1 Cum. Bull. (Part 2) 632]. However, the significance of the additional words was considered by

this Court in *Ehrman v. Com'r,* 120 F. 2d 482, 485 (9th Cir. 1941), *cert. denied* 314 U.S. 668. In that case it was "urged that the addition of these words indicate an intention by Congress to exclude from taxation as ordinary gains sales such as the ones with which we are here concerned."

> "We do not agree. If, as we have held the fact to be here, the taxpayers were in the 'trade or business' of real estate subdivision, then certainly the sales of lots were to 'customers' in the 'ordinary' course of that business."

This conclusion is apparently consistent with the current position of the Government, as urged to the Supreme Court in its brief in the *Malat* case, *supra.* In response to the taxpayer's contention that a sale between joint venturers was not a sale to customers in the ordinary course of business, the Solicitor General argued (pp. 29-30):

> "The courts have long held that anyone engaged in the business of selling property sells it to customers whenever he finds someone who will purchase it. In one frequently cited case the Board of Tax Appeals held that:
>
> > Where, as here, one is regularly engaged in the business of buying and selling real estate, as was petitioner, any person who can be found to buy such property is a customer as that term is ordinarily understood, and where such property is held for sale under such circumstances it must be deemed to be held for sale to customers within the meaning of the statute. [*Black v. Commissioner,* 45 B.T.A. 204, 210.]
>
> As Judge Learned Hand stated the same principle, those 'whose custom the taxpayer seeks * * * are

his "customers." ' *Goldsmith v. Commissioner,* 143 F. 2d 466, 468 (C.A. 2), certiorari denied, 323 U.S. 774. See also *Gamble v. Commission,* decided October 27, 1955 (P-H Memo T.C., para. 55,289, affirmed, 242 F. 2d 586 (C.A. 5) ('one engaged in the continuous purchase and sale of property, as this petitioner was, has dealings with a "customer" whenever he sells.'); *Pennroad Corp. v. Commissioner,* 261 F. 2d 325, 330 (C.A. 3), certiorari denied *sub nom. Madison Fund, Inc. v. Commissioner,* 359 U.S. 958; *Stockton Harbor Industrial Co. v. Commissioner,* 216 F. 2d 638 (C.A. 9), certiorari denied, 349 U.S. 904. *Cf. Watson v. Commissioner,* 345 U.S. 544."

The Tax Court has adopted a like view with respect to the sale of patents. *M. L. Lockhart,* 16 TCM 474, 477; *H. T. Avery,* 47 B.T.A. 538.

Although the statute may have been amended in 1934, with security traders in mind, there is nothing in the statute limiting the application of the language there set forth to stock speculators or otherwise. As the Supreme Court pointed out in its very recent decision in *Malat, supra,* 383 U.S. at 572:

> "The purpose of the statutory provision with which we deal is to differentiate between the 'profits and losses arising from the everyday operation of a business' on the one hand (*Corn Products Co. v. Commissioner,* 350 U.S. 46, 52) and 'the realization of appreciation in value accrued over a substantial period of time' on the other. (*Commissioner v. Gillette Motor Co.,* 364 U.S. 130, 134). A literal reading of the statute is consistent with this legislative purpose."

In view of this Court's decision in *United States v. Chinook Inv. Co., supra*, 136 F. 2d at 985, that §117(b) of the Revenue Act of 1936, containing substantially identical language to §1221(1), "is not concerned with securities alone, but deals with all 'property,'" and that there was a "regular business roughly comparable with that of a dealer in hogs or cattle or town lots, finding its customers where it could.", there is no doubt that the statute must be read and interpreted consistently for those whose business is the sale of securities, hogs, cattle, and town lots. See, *Pool v. Com'r*, 251 F. 2d 233 (9th Cir. 1957), *cert denied*, 356 U.S. 938.

It is further immaterial how a taxpayer conducts his business, whether through agents or brokers. *Welch v. Solomon*, 99 F. 2d 41, 43 (9th Cir. 1938); *Margolis v. U.S.*, 337 F. 2d 1001, 1007, reh. 339 F. 2d 357 (9th Cir. 1964). As a necessary corollary, it is immaterial that the taxpayer's agent may locate a purchaser or a purchaser's agent on an exchange. The method of selling described in the *Pool* case, *supra*, 251 F. 2d at 243-246, was considered immaterial in that the taxpayers did not deal with the individual purchasers and had no idea who their customers were, *e.g.* "Most of the paper work was in the name of the taxpayers, who executed escrow instructions and deeds in blank long in advance of a sale." 251 F. 2d at 248. Similarly, this Court, in characterizing as ordinary, and not capital, gains from the sale of subdivided ranch property held in *Kelley v. Com'r*, 281 F. 2d 527, 529 (9th Cir. 1960):

> "That taxpayers . . . used the services of a real estate broker in transacting sales does not compel capital gains treatment. See Ehrman v. Commissioner, 120 F. 2d 607 (9th Cir.) cert. denied, 314

U.S. 668 (1941); Welch v. Solomon, 99 F. 2d 41 (9th Cir. 1938); Richards v. Commissioner, 81 F. 2d 369 (9th Cir. 1936)."

If necessary, expert testimony could be introduced at a trial of the instant actions to show that over-the-counter brokers who inventory unlisted securities, odd lot dealers, and specialists (see *Vaughn v. Com'r,* 85 F. 2d 497, 499 (2d Cir. 1936), *cert. denied,* 299 U.S. 606), often sell securities to undisclosed persons through brokers, at the same time realizing ordinary income and loss on all their sales. The confusion surrounding the various appellations given to those in the securities' business is shown by Judge L. Hand's conclusion in *Seeley v. Helvering,* 77 F. 2d 323 (2d Cir. 1935). In that case, which involved the question of whether the taxpayer was entitled to compute his income by use of inventories, the taxpayer was "what is commonly known as a 'floor trader,' and he had no personal customers." Yet in holding that the taxpayer was not entitled to inventory securities because he did not fit the definition of dealer set forth in the regulations, Judge Hand said: "A 'floor trader' would indeed be quite naturally described as a 'dealer in securities,' but nobody would think of calling him a 'merchant' with 'customers.' " 77 F. 2d at 324.

In light of the foregoing obfuscating appellations given to those in the business of dealing in securities,*

*In *Dart v. Com'r,* 74 F. 2d 845, 847 (4th Cir. 1935), an action involving the deductibility of dividends paid consequent to a short sale, the court rejected a distinction urged by the Government that there was a difference between dealers who are engaged in carrying on a trade or business in the buying and selling of securities and those who are not dealers but buy and sell securities for their own account. This opinion allowing such short dividends as a business expense was followed by this Court in *Com'r v. Wilson,* 163 F. 2d 680, 682 (9th Cir. 1947) cert. denied 332 U.S. 842.

it is quite apparent that irrespective of whether the taxpayer knows the person to whom he sells, whether via the medium of another broker or through an exchange, if he is in the business of buying and selling securities, hogs, cattle or town lots, the same result should obtain: ordinary income and loss. This in effect is the result reached in *Margolis v. Com'r,* 337 F. 2d 1001, 1004, reh., 339 F. 2d 537 (9th Cir. 1964), in which this Court concluded:

> "Where one is engaged in the business of buying and selling real estate on as broad a basis as was taxpayer, the fact that property was acquired with the intention of holding it for a substantial period of time before sale, is not sufficient to constitute it an investment. If the purpose of the acquisition and holding and the only manner in which benefit was to be realized from the property acquired was ultimate sale at a profit, its acquisition and holding by a dealer such as taxpayer must be considered to have been for sale to customers in the ordinary course of business."

IV.

Federal Transfer Taxes Incurred on the Sale of Securities by a Taxpayer Whose Business Is That of Buying and Selling Securities Are Deductible as an Ordinary and Necessary Business Expense.

Conclusion of Law, paragraph 5, unconditionally provides that federal stamp taxes paid on the sale of securities are not deductible as an ordinary and necessary business expense, but are offsets against the selling price.

Under the well-reasoned decision in *Hirshon v. U.S.*, 113 F. Supp. 444, 445 (Ct. Cl. 1953):

> "If one's business is that of trading in stocks, and if he must pay a tax whenever he trades, the tax would seem to be an ordinary and necessary business expense, and therefore deductible under the express terms of the statute."

Accordingly, such federal stamp taxes are deductible by this taxpayer, in view of its activities in buying and selling stocks, and the net operating loss for the 1962 fiscal year should be further increased by $1,592.60, the federal transfer taxes paid in that year.

Conclusion.

Since the District Court erred in denying the plaintiff the right to a trial on the issues involved, the judgment appealed from should be reversed.

Respectfully submitted,

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Dated: September 19, 1966.

Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

ROBERT H. WYSHAK